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Letter From the Editor:

“Intellectual growth should commence at birth and cease only at death” - Albert Einstein

I always believe that life is full of unknowns, and to achieve the full potential of life, we have to keep on learning. I joined the SJSU MST program with little knowledge about taxation, but now I believe that I have built a solid foundation in this area. However, my learning will never stop even after I graduate from the MST program. With changes continuously happening in various fields of taxation, we need to keep up with the news and always look to broaden our knowledge. It is with this curiosity of learning that we bring to you the Spring/Summer 2015 edition of The Contemporary Tax Journal, a publication of the SJSU MST program.

We begin this issue with a tax enlightenment article about offshore web-based gambling accounts. The author brings our attention to a recent district court’s holding that the online gambling accounts are subject to FBAR.

Next, we are very grateful for an expert contribution from Bret N. Bogenschneider, PhD Candidate, *Vienna University of Economics and Business*. His article focuses on federal excise tax exemption for U.S. gasoline exports.

The TEI-SJSU Annual High Tech Tax Institute has always been an important part of the MST journal. In this issue, the summaries of the sessions from the 30th High Tech Tax Institute focus on trending tax issues facing high-tech companies in Silicon Valley. In the ‘Tax Maven’ section, the interview with Ms. Handy Hevener offers special insights into the employee benefits and executive compensation area of tax practice. The “Focus on Tax Policy” section features an analysis of tax rules related to personal casualty loss deduction using the principles of good tax policy outlined by the AICPA.

Finally, I would like to thank Professor Annette Nellen and Professor Joel Busch for their continuous guidance and invaluable support for the journal. In addition, I would like to thank all my fellow MST students for their contributions towards the journal.

Dear readers, we hope you will enjoy this issue and can learn something new from it.

Jun Xie

Student Editor

Offshore Web-based Gambling Accounts are Subject to FBAR

By: Min K. (Megan) Park

As the Internet continues to grow at the speed of light, various convenient funding methods are available to consumers beyond their geographical locations. A person who owns online accounts that function as traditional bank accounts should be aware of a recent district court's holding on online gambling accounts.

U.S. v. HOM, 113 AFTR 2d 2014-2325, (DC CA, 2014)

In a recent case, the Northern District Court of California held that online gambling accounts through offshore Internet sites were subject to foreign bank and financial accounts (FBAR) filing requirements and upheld the IRS in its assessment of penalties against the taxpayer for the non-willful failure to report the accounts.

Under the Bank Secrecy Act (31 USC §5314) and pertinent regulations, an individual must file a FBAR (FinCEN Form 114) for the previous year by June 30 if a taxpayer meets the following elements: ① he or she is a United States person; ② he or she has a financial interest in or signature or other authority over a bank, securities, or other financial accounts; ③ the bank, securities, or other financial account is in a foreign country; and ④ the aggregate amount in the accounts exceeds \$10,000 in U.S. currency at any time during the year

(31 CFR 103.24). The Secretary of the Treasury can prescribe statutory regulations to determine the method of reporting requirements based on explicit empowerment by the Bank Secrecy Act.

Failure to timely file the FBAR can lead to substantial penalties. The potential civil monetary penalty for filing violations that are deemed non-willful can be as high as \$10,000 with penalties for willful violations as high as the greater of \$100,000 or 50% of the balance in the account at the time of the violation. Furthermore, a willful violator can face additional criminal penalties of substantial imprisonment time and additional fines of up to \$500,000. Penalties, however, may be waived in cases where the omission of reporting was due to reasonable cause.¹

In 2006 and 2007, John Hom, a U.S. citizen, maintained online gambling accounts with PokerStarts.com and PartyPoker.com (offshore Internet gambling sites) to deposit money or make withdrawals for his gambling by using his FirePay² account, which was funded by his domestic financial accounts (Wells Fargo, Western Union). His gambling accounts were continuously funded via his domestic financial accounts despite FirePay discontinuing services to U.S. customers for transferring funds to offshore Internet gambling sites. The aggregate amount of funds in his FirePay, PokerStars, and

¹ 31 U.S.C. 5321 and 5322

² FirePay.com: an online financial organization that receives, holds, and pays funds on behalf of its customers

PartyPoker accounts exceeded \$10,000 in U.S. currency at some points in both 2006 and 2007.

Per 31 USC §5321(a)(5), the IRS assessed penalties for his non-willful failure to submit FBARs (a \$10,000 penalty for each account): a \$30,000 penalty for 2006 and a \$10,000 penalty for 2007, respectively.

Both parties conceded that the facts in this case met the first (① a U.S. Person) and fourth (④ \$10,000 Requirement) FBAR requirements.

The only issues in this case were whether Hom's gambling accounts were "a bank, securities, or another financial account" (second element) and whether each of the three accounts was in a foreign country (third element).

While analyzing the requirement of the second element (② interest in "a bank, securities, or other financial accounts"), the court cited the 4th Circuit's holding in *U.S. v. Clines*³ that "by holding funds for third parties and disbursing them at their direction, [the organization at issue] functioned as a bank [under 31 USC §5314]." The court also cited 9th Circuit's holding in *U.S. v. Dela Espriella*⁴ case that "the term 'financial institution' is to be given a broad definition."

The court viewed FirePay, PokerStars, and PartyPoker function as institutions engaged in the business of banking and concluded his accounts were subject to FBAR because the

accounts were under his name, he controlled access to the accounts and deposited money into the them, he withdrew or transferred money from the accounts to other entities at will, and the accounts could carry a balance.

The court did not accept Hom's argument that his accounts were not "other accounts" as defined by 31 CFR 103.24 because FirePay, PokerStars, and PartyPoker function as institutions engaged in the business of banking. Thus, the accounts were subject to FBAR.

The court's decision on the issue in light of the third element, which regards whether the accounts were "located in" foreign countries, was in favor of the IRS determining foreign financial institutions according to where they were incorporated and operated, rather than the physical location of their funds. Hom's argument that "located in" refers to the geographic location of the funds was denied.

Hom's accounts with FirePay, PokerStars, and PartyPoker were managed through the companies' websites that were located outside of the United States. FirePay was located in and regulated by the United Kingdom. PokerStars was licensed and regulated by the government of the Isle of Man. PartyPoker was licensed, regulated, and headquartered in Gibraltar.

Therefore, the court held that Hom's accounts were located in foreign countries because FirePay, PokerStars, and PartyPoker were foreign institutions, which opened and maintained his accounts outside of the U.S. regardless of where these three companies place their own funds.

³ *U.S. v. Clines*, 958 F.2d 578 (4th Cir 1992)

⁴ *U.S. v. Dela Espriella*, 781 F.2d 1432 (9th Cir. 1986)

Hom's argument over the IRS's instructions to the 2010 FBAR reporting form, which stated, "[t]he geographic location of the account, not the nationality of the financial institution in which the account is found determines whether it is an account in a foreign country", was rejected by the court because the instructions had no legal weight.



Submit FBAR

Therefore, the court upheld the IRS's determination of FBAR requirements and the imposition of penalties for the non-willful failure to report three offshore, web-based gambling accounts.

The IRS has yet to explicitly state that virtual currency accounts (e.g. bitcoin) are subject to FBAR requirements. However, this case is worthy of notice to a taxpayer who has offshore digital accounts or currency. If the account functions as a bank account, taxpayers may consider filing FBAR for their accounts and staying tuned for future developments on this issue

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Articles must be original work. Articles should be 8 to 16 double spaced pages (2,500 to 6,000 words). Articles are subject to blind peer review.

Submission deadlines:

Fall Issue: 1st August

Spring Issue: 1st February

For more information on the article submission process, please see the submission on our website

<http://www.sjsumstjournal.com>

Featured Article

On the Federal Excise Tax Exemption for U.S. Gasoline Exports

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Abstract:

Exports of refined gasoline are exempt from Federal excise taxation. Accordingly, an increase in the Federal excise tax on gasoline may simply increase the market price of gasoline in the U.S. and encourage the export of gasoline to foreign markets, primarily West Africa and Latin America. Any reduction in negative environmental externalities from an increase in the Federal gasoline excise tax in the United States is therefore likely to be mooted (or perhaps made worse) on a global basis. The Federal excise tax on gasoline appears to be the most regressive form of taxation when both direct and indirect costs are taken into account. This article is the first to estimate the indirect costs (i.e., imbedded transports costs) to U.S. persons of a Federal gasoline and diesel taxes using data from the Consumer Expenditure Survey of 2012. This article further updates and expands Poterba's (1991) empirical calculation of the regressivity of the Federal gasoline tax based on direct gasoline expenditures. Finally, this article recommends that the Jones Act restrictions on gasoline shipment between the Gulf Coast refineries and East Coast terminals be removed.

Keywords: *gasoline taxes; excise tax; pigou.*

JEL Classification: H20; K34

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I. Introduction.

Much of the prior legal and economic literature on Federal gasoline taxation proposes a Pigovian tax approach where the individual American consumer is forced into paying the full price at the pump to account for any externalities from the consumption of gasoline.⁵ The negative externalities can therefore be reduced or optimized by domestic tax policy alone.⁶ But, according to the Congressional Budget Office and National Research Council, the estimate of gasoline externalities is 26 cents per gallon, but the currently existing Federal and state gasoline taxes average 41 cents per gallon.⁷ The combined gasoline excise taxes more than account for the externalities by this estimate. Thus, not only is the gasoline tax not a “free lunch” to the economy, but there is an “excess

burden” of this taxation. As explained by Goldin (2012): “Commodity taxes generate excess burden by distorting consumers’ decisions about which goods to purchase.... The larger these ‘avoidance costs’ the greater the tax’s excess burden.”⁸

Gasoline taxes also fall disproportionately on the persons least able to pay. Within the discipline of tax policy this is referred to generally as a “regressive” form of taxation. Brunner-Brown (2013) translates such tax theory into the domestic *economic policy* implications of the excise tax, (i.e., the “incidence” of the gasoline excise tax), as follows:

Excise taxes are not the solution to transportation preference and automobile congestion because they are simply ineffective. Excise taxation discounts the variety of other externalities that affect transportation selection... the increased costs may impose a large, disproportionate burden on those least able to pay them.... This is not consistent with policy goals, but rather conflicts with optimal transportation mode composition.⁹

⁵ N. Gregory Mankiw, *Smart Taxes: An Open Invitation to Join the Pigou Club*, EASTERN ECON. J. 35 (2009) (“The economics here is straightforward: emitting carbon into the atmosphere entails a negative externality. In absence of any policy, people will emit too much. The Pigovian policy response is to impose a tax on carbon emission.”); N. Gregory Mankiw, *Gas Tax Now!* Fortune Magazine (May 24, 1999); Shi-Ling Hsu, *The Politics and Psychology of Gasoline Taxes: An Empirical Study*, 15 WIDENER L. REV. 363, at Note 2 (2010) citing William J. Baumol & Wallace E. Oates, *The Theory of Environmental Policy* 21-23 (2d ed. 1988). (“‘Pigouvian’ is meant to describe a tax that would be consistent with Pigou’s prescription that a tax equal to the marginal social harm from pollution should be imposed to provide just the right amount of disincentive for pollution. Alfred C. Pigou, *The Economics of Welfare* (1928). Taxes that reflected the extent of negative externality thus became known as “Pigouvian” taxes.”).

⁶ Congressional Budget Office, *The Economic Costs of Fuel Economy Standards Versus a Gasoline Tax* (Dec. 2003) at v.

⁷ *Id.*

⁸ Jacob Goldin, *Sales Tax Not Included: Designing Commodity Taxes for Inattentive Consumers*, 122 YALE L.J. 258, 276 (2012) (“Consumers who substitute away from the taxed good do not contribute to the tax’s revenue; but, having switched their consumption to a less desirable bundle of goods in order to avoid the tax, they are still worse off because of the tax.”).

⁹ John Andrew Brunner-Brown, *Thirty Minutes or Less: The Inelasticity of Commuting*, 43 GOLDEN GATE U. L. REV. 355 (2013).

But, an optimal transportation analysis of economic policy analysis takes into account only the *domestic* U.S. policy implications of an increase in the Federal excise tax on gasoline. People all over the world use gasoline – not just Americans. Indeed, gasoline, diesel fuel, and other refined petroleum products exported out of the United States are *exempt* from the Federal excise tax.¹⁰ As a matter of *international tax policy*, if either gasoline or crude oil is a commodity that can be *exported* to other nations, then the policymaker must consider both the domestic and *international* implications of a domestic excise tax on that commodity in the United States.¹¹ This is especially true where the exports of gasoline are exempt from *taxation*, thereby creating a potential tax incentive to export gasoline (or diesel). As it turns out, U.S. refiners indeed exported at least 18% of total gasoline

¹⁰ 26 U.S.C. §§ 4081, 4083; IRS Publication 510 at 6 (“Exception. The tax does not apply to a sale if all of the following apply: The buyer’s principal place of business is not in the United States; The sale occurs as the fuel is delivered into a transport vessel with a capacity of at least 20,000 barrels of fuel; The seller is a registrant and the exporter of record; The fuel was exported.”); *see also*: Practical Law (Thomson Reuters) available at <http://us.practicallaw.com/1-524-3130?q=&qp=&qo=&qe=> (last checked December 8, 2014) (“Taxes on the import and export of oil and gas: USA. Oil Spill Liability Trust Fund Tax imposed on petroleum produced in or imported to the US: 2009 to 2016: US \$0.08 per barrel. 2017: US \$0.09 per barrel. Tariffs on oil imports range from US\$0.0525 to US\$0.525 per barrel depending on the type of petroleum. Oil and petroleum products from some countries are duty-free due to trade agreements and Congressional programmes.”).

¹¹ Theo Eicher, John Mutti & Michelle Turnovsky, *International Economics* (7th ed.) (Routledge Publishing, New York, 2009) at 143.

refined as of the year 2011.¹² The anecdotal reports from major news agencies suggest both gasoline and U.S. crude oil exports may be increasing.¹³ However, since the Energy Information Agency relies exclusively on data provided by the American Petroleum Institute, an exact or more up-to-date gasoline export data remains unavailable.

Accordingly, because the prior economic analysis does not seem to consider the potential for export of gasoline by U.S. refiners to world markets without payment of the Federal excise tax, the “poll” of economists of Federal gasoline taxes may represent more fundamentally a survey of the proportion of economists who favor *regressive* domestic tax policies generally.¹⁴ As to Federal excise taxes in particular, such classic tax policy view is given anecdotally as: “Bah, let them drive a hybrid!” But, several empirical studies now show that low-income persons are often unable to drive fuel-efficient

¹² U.S. Energy Information Administration. Independent Statistics and Analysis available at <http://www.eia.gov/tools/faqs/faq.cfm?id=687&t=10> (“Gasoline exports were about 18% of total U.S. petroleum product exports in 2011.... Distillate fuel exports were about 30% of total U.S. petroleum product exports in 2011.”).

¹³ Reuters, *U.S. Refiners Export More Fuel Than Ever: American Companies Export Energy Boom World-Wide* (Oct. 8, 2013); The Washington Times, *U.S. energy giants use crude oil loophole to post record petroleum exports* (May 11, 2014).

¹⁴ Mankiw, *supra* Note 1 at 21-2 (“[P]art of a US gasoline tax gets paid by the producers of oil, not the consumers. This is an example of what economists call the optimal tariff argument.... Some might fear these taxes would be particularly hard on those at the bottom of the economic ladder. Yet that is not necessarily the case.... The poor are far more likely than higher-income households to ride the bus or subway to work.”).

vehicles. Chernick & Reschovsky say: “The data indicate that poorer families tend to drive older and less fuel efficient cars than families with higher incomes.”¹⁵ As West (2005) further explains, “poor vehicle owning households drive vehicles that pollute more than those owned by wealthy households.”¹⁶ Thus, the classical tax policy view becomes the modern environmental law equivalent to Marie Antoinette’s supposed glib: “Bah, let them eat cake!”¹⁷

This article summarizes and expounds the prior literature on the *regressive* effects of gasoline taxation. The indirect cost of gasoline taxation was excluded from Poterba’s (1991) seminal economic study.¹⁸ Therefore, in order to generate a comprehensive estimate of the regressive effect of gasoline taxation, the *indirect cost* of the Federal gasoline tax must be calculated in addition to the *direct tax expenditures* paid by

¹⁵ Howard Chernick & Andrew Reschovsky, *Who Pays the Gasoline Tax?* 50 NAT’L TAX J. 2 (1997).

¹⁶ Sarah E. West, *Equity Implications of Vehicle Emissions Taxes*, 39 JRN’L OF TRANSPORT ECON & POL’Y 1 (2005); *see also*: James A. Kahn, Gasoline Prices and the Used Automobile Market: A Rational Expectations Asset Price Approach, 101 Quart. J. Econ. 2 (1986).

¹⁷ Jean-Jacques Rousseau (1765). *Confessions*. (ed. Angela Scholar) (New York: Oxford University Press, 2000) at 262 (misattributing *perhaps* the quote to Marie Antoinette “*Qu’ils mangent de la brioche*.” The quote does appear to be correctly attributed to an unidentified contemporaneous princess of the period.).

¹⁸ James M. Poterba, *Is the Gasoline Tax Regressive?* in “Tax Policy and the Economy” v. 5 (ed. David Bradford) (The MIT Press 1990), at 150 (“This study does not attempt to analyze the distribution of indirect gasoline tax expenditures, i.e., the taxes that may be collected from the retail distribution sector but eventually passed on to consumers.”).

U.S. consumers of gasoline. Such an analysis is necessary because diesel fuel and gasoline are used to transport many consumer goods. In this article, we therefore expand and update the results of Poterba (1991) who applied the Consumer Expenditure Survey of 1985, to calculate the regressivity of direct gasoline expenditures by income level. However, here we go beyond Poterba’s (1991) analysis and also estimate the indirect costs of gasoline taxation. The indirect effects are found to be roughly an incremental 50% increase in the respective *regressive* effects of the gasoline expenditures by U.S. households from prior measurements. Accordingly, comparing generally the recent calculation by Bogenschneider (2014) on the regressivity of payroll taxation, the gasoline tax appears to be the most regressive of any form of domestic taxation.¹⁹

Finally, this article traces the tax subsidies offered in the Internal Revenue Code to oil producers, and compares these in magnitude with Federal excise tax collections. The ability of U.S. refiners to export refined gasoline to foreign markets appears to partially moot (or reverse) both the potential national security and carbon reduction externality justifications for higher rates of Federal gasoline taxation given by numerous economic studies. Nonetheless, if the policymaker considers these to be important policy goals, then a comparison of the regressive effect of gasoline taxes to the potential policy benefits of such tax policy is required.

¹⁹ *See*: Bret N. Bogenschneider, *The Effective Tax Rate of U.S. Persons by Income Level*, 145 TAX NOTES 117 (Oct. 6, 2014).

As to the Federal excise tax on gasoline good policy options are available. The Jones Act set strict maritime limits on the tankers which can be used to ship refined gasoline from the Gulf Coast refineries to the East Coast distribution terminals.²⁰ Accordingly, the cost of shipping gasoline by tanker to Western Africa is alleged to be less than the cost of shipment to the East Coast.²¹ The shipping cost issue is thus given as an explanation for the export of refined gasoline from the Gulf Coast. The policy purpose of the Jones Act appears to be both to ensure U.S. persons are employed in the maritime transport of refined gasoline between U.S. ports, and also an environmental protection goal that tankers operating between U.S. ports be subject to U.S. regulation to avoid the potential of a gasoline spill in coastal waters. Both of these policy goals are very important. However, the recent B.P. oil spill in the Gulf of Mexico indicates any presumption that U.S. crewmembers may be able to implement better safety

²⁰ The Merchant Marine Act, codified as 46 U.S.C. § 30104 (Oct. 6, 2006).

²¹ Business Week, *Are U.S. Gasoline Exports About to Goose Prices at the Pump?* (Nov. 25, 2013) (“West Africa is also taking more U.S.-made fuel. Exports to Nigeria shot up to 2.7 million barrels in August. Driving this growth is a strange price incentive that’s largely a function of the Merchant Marine Act of 1920 (known also as the Jones Act), which requires goods transported between U.S. ports to be carried on vessels based in the U.S., made in the U.S., and crewed mostly by U.S. citizens. A shortage of these ships has created a bizarre scenario where it’s cheaper to ship gasoline from Texas to Nigeria than it is to ship it to New York, or to Florida for that matter. ‘I can ship a barrel of gasoline across the Atlantic for one-third the cost of shipping it to New York from Houston,’ says Fadel Gheit, an oil and gas analyst at Oppenheimer. Gheit estimates there are only 28 vessels certified by the Jones Act that are allowed to ship fuel between U.S. ports. He calls them ‘the chosen ones’.”).

conditions is inconclusive. The primary thesis of this paper is that the Jones Act should be modified to encourage the maritime shipment of refined gasoline from the Gulf Coast to the East Coast.

The remaining possibility is that the shipment of refined gasoline from the Gulf Coast to West Africa and other locations did not occur because of incremental maritime shipping costs, but was instead done primarily for tax avoidance purposes. All the data indicates the United States is simultaneously importing and exporting refined gasoline. Therefore, based on the available evidence we cannot *exclude* the possibility that the market price of gasoline in the United States might be higher than the market price of gasoline in Latin America or West Africa, but *higher by less* than the amount of the incremental Federal excise tax avoided by exporting the gasoline. Thus, it appears at least *possible* that U.S. refiners are exporting gasoline to meet market demand in West Africa, Latin America, and other nations at the lower market price specifically in order to avoid the excise tax. Notably, the net carbon effect externalities may be *negative* depending on the efficiency of the gasoline usage abroad – especially if any portion of the gasoline is allowed to evaporate directly into the atmosphere or by spillage from open containers. Under these assumptions, the tax policy options become multi-faceted. Based on its current international treaty obligations the United States might be able to impose a tariff on exported gasoline to those nations receiving gasoline imports equivalent to the amount of the excise tax.²² However,

²² See generally: 19 U.S.C. §2504(a).

if the United States is prohibited by international treaty obligations from imposing such a tariff, then the “deadweight loss” from the excise tax on gasoline would need to be calculated *in addition to* the incremental negative externalities.

II. An Estimation of the *Indirect* Regressivity of Federal Excise Taxes on Gasoline.

The Bureau of Labor Statistics publishes the Consumer Expenditure Survey with the most current edition being that of 2012. No economic study exists on the imbedded diesel or gasoline fuel costs in consumer goods representing the *indirect cost* of diesel fuel and gasoline excise taxes. However, Cooper (2014) recently published a calculation of trucking fuel costs by U.S. household based on the Consumer Expenditure Survey of 2010.²³ Here, we update both studies to the year 2012 as set forth in Table 1, Column(s) 1, 2. In addition, the methodology by Cooper (2014) is followed except with the indirect fuel costs allocated by relative household *expenditures* rather than by total *households*.²⁴

²³ Mark Cooper, *Paying the Freight: The Consumer Benefits of Increasing the Fuel Economy of Medium and Heavy Duty Trucks*, Consumer Federation of America (February, 2014) available at <http://www.consumerfed.org/pdfs/Paying-the-Freight.pdf>.

²⁴ *Id.* at 4.

Table 1. Direct and Indirect Gasoline Expenditures by Income Quintile (2012).

U.S. Persons by Income Level:	Direct Gas Expenditure / Income (%) (2012)	Indirect Gas Expenditure / Income (%) (2012)	Combined / Income (%) (2012)
Lowest 20 Percent	12.51%	8.56%	21.08%
Second 20 Percent	7.31%	4.52%	11.82%
Third 20 Percent	5.83%	2.02%	7.85%
Fourth 20 Percent	4.45%	2.96%	7.41%
Highest 20 Percent	2.53%	0.00002%	2.53%

Notes: Indirect Gas Expenditure based on Cooper (2014) study with total commercial fuel expense as \$234 billion (most recent data, 2010) allocated as a ratio of total expenses and expressed as a percentage of income based on actual CES household data for 2012. Income is presented without income accruals for holdings gains. The incidence of the indirect gasoline tax is assumed to fall entirely on the end consumer.

Poterba (1991) published a calculation on the regressivity of direct gasoline expenditures based on the Consumer Expenditure Survey of 1985 as reproduced here in Table 2. The calculation is updated based on the Consumer Expenditure Survey of 2012.

Table 2. Comparison of Direct Gasoline Expenditures by Income Quintile 1985 vs 2012.

U.S. Persons by Income Level:	Direct Gas Expenditure / Income (%) (1985)	Direct Gas Expenditure / Income (%) (2012)
Lowest 20 Percent	8.99%	12.51%
Second 20 Percent	6.22%	7.31%
Third 20 Percent	4.83%	5.83%
Fourth 20 Percent	4.07%	4.45%
Highest 20 Percent	2.98%	2.53%

Notes: Data simply updated from Poterba (1991). Income is presented without income accruals for holdings gains.

In each version of the Consumer Expenditure Survey from 1985 to 2012 the lowest income persons are seen to accrue expenditures which *exceed* income. Therefore, Poterba (1991) and Mankiw (2009) both cite this as justification for using a ratio of relative expenditures (in lieu of reported income) to calculate the regressivity of the excise tax on gasoline. By comparing total expenditures to direct gasoline expenditures Poterba (1991) was therefore able to say only the middle income quintiles were worse off relative to the highest income quintiles. The implication appears to be that low-income persons are receiving transfer payments *not included in income* to purchase gasoline, and therefore are not made worse off by the Federal excise tax.

However, most transfer payments received by the poor are considered “income” by the Federal government and measured by the survey. One exception might be “food stamps”, but obviously food stamps are not gas stamps. Instead, the “higher” expenditures measured in the survey appear to relate to retired persons in the lowest income bracket spending *out of savings* in retirement. If low-income retired persons are forced to use savings to buy gasoline this does not diminish the regressivity of a tax. This simply changes the meaning of the word “regressive” from its colloquial definition. Accordingly, Poterba’s (1991) relative expenditure calculation relating to expenditures by the elderly from savings is not presented here.

III. Crude Oil Production Tax Subsidies versus Federal Excise Tax Revenues.

As set forth in detail here, *infra* Table 3, the crude oil production subsidies offset approximately one-third (1/3) of the total Federal excise tax receipts. The data here is a composite of three Joint Committee on Taxation scoring estimates and a General Accounting Office report some of which were summarized by Kolarova (2012).²⁵ The domestic crude oil production level is increasing in the Upper Midwest region so the prior year estimates may understate the tax expenditure effect. Also, domestic gasoline consumption is declining slightly and the most recent Excise Tax data is from the year 1999 which would tend to overstate the tax expenditure effect.

²⁵ Temi Kolarova, *Oil and Taxes: Refocusing the Tax Policy Question in the Aftermath of the BP Oil Spill*, 42 SETON HALL L. REV. 351 (2012).

The data presented here is a side-by-side comparison of the Federal Crude Oil Tax subsidies versus the Federal Excise Tax revenues.

Table 3. Crude Oil Tax Subsidies versus Federal Excise Tax on Gasoline

<u>Excise Tax (gasoline & diesel):</u>		
IRC §4081 (¢18.4 gas; ¢24.4 diesel) (1999)	\$21,236,659	
<u>Income Tax Subsidies (U.S. crude oil):</u>		
Foreign Tax Credit Disguised Royalties (§907)		(\$2,550,000)
Domestic Manufacturing Deduction (§199)		(\$1,825,000)
Oil Well Percentage Depletion (§613)		(\$1,625,000)
Last-in First-Out (LIFO) Accounting (§263)		(\$860,000)
Intangible Drilling Cost Expensing (§263)		(\$650,000)
Tertiary Injection Expensing (§193)		(\$100,000)
Enhanced Oil Recovery Credit (§43)		(\$100,000)
	\$21,236,659	(\$7,710,000)
	<u>Net:</u>	\$13,526,659

Notes: (*amounts in thousands*) An \$0.08 per barrel Oil Spill Liability tax applies to Crude Oil production. Any increase in production in recent years would increase the subsidy estimate. The Superfund trust fund liability tax expired in 1995.

Such data appears to indicate a possible “rule-of-thumb” is one-third (1/3) of total excise tax receipts are offset by the subsidies to the oil companies.

IV. Estimate of Foregone Revenue on Exempt Exports of U.S. Gasoline.

The Congressional Research Service (“CRS”) provided a report in April, 2012, summarizing the total U.S. exports of petroleum products. This report makes it possible to estimate the foregone revenue from the excise tax exemption on gasoline and diesel fuel exported out of the United States. The CRS report provided as follows:

U.S. oil exports, made up almost entirely of petroleum products, averaged 2.9 Mb/d in 2011. This is up from export of 1.2 Mb/d in 2005, led by growing export of distillates (diesel and related fuels) and gasoline. More than 60% of U.S. exports went to countries in the Western Hemisphere, particularly to countries such as Mexico and Canada from which the U.S. imports crude oil. Exports occur largely as a result of commercial decisions by oil market participants which reflect current oil market conditions as well as past investment in refining.²⁶

Based on this data an estimate of the potential (i.e., foregone) revenue from the failure to levy excise tax on exported petroleum products including gasoline, diesel and other condensates is presented here in Table 4, *infra*.

²⁶ Neelesh Nerurkar, *U.S. Oil Imports and Exports*, Congressional Research Service (April 4, 2012).

Table 4. Estimate of Foregone Revenue from Excise Tax Exemption on Exported Gasoline

Barrels Millions/per day exported (CRS, 2011)	2,900,000
Gallons Conversion (31.5 gallons/barrel)	91,350,000
Annualized	33,342,750,000
Excise tax rate ¢20.4 (2/3 gasoline; 1/3 diesel)	6,801,921,000
<u>Foregone Excise Tax:</u>	\$6.8 billion

An additional portion of the CRS report may provide insight into the failure to levy an excise tax on gasoline exports. The CRS report stated:

Oil Export Tariff. Instead of prohibiting exports, some have suggested a federal tax, tariff, or duty on exports. However, these are generally prohibited by Article 1, section 9, clause 5 of the U.S. Constitution, which states that “No Tax or Duty shall be laid on articles exported from any State.”

To the contrary, the U.S. Constitution obviously does not prevent the Federal government from levying a tax on exported gasoline or any petroleum product. The provision cited prevents *each individual state* within the United States from levying such a tariff. However, that is irrelevant to the Federal government’s power to levy the excise tax on petroleum products. Also the U.S. Constitution’s prohibition on direct taxes does not apply to the excise tax applied on export of a petroleum product. As such, it appears possible that some

members of Congress and their staff are confused about the potential to tax exports of gasoline under the U.S. Constitution.

V. Analysis of the Incidence of an Increase in Federal Excise Taxes on Gasoline.

Much to the contrary, a significant increase in the Federal excise tax on gasoline without a prohibition on gasoline exports from the United States could become an economic and environmental calamity. The incidence of the tax increase would fall almost entirely on U.S. consumers and producers thereby harming the relative competitiveness of the U.S. economy.²⁷ Indeed, aggregate demand for gasoline in the United States would decrease. However, gasoline refiners could then be expected to export an increasing proportion of the production of gasoline and other condensates thereby causing a decrease in gasoline price in foreign markets, and increasing the foreign demand for gasoline at the *now lower* price. This is standard fair in any course in International Economics.²⁸ Furthermore, because the environmental protections are lower in some of the gasoline export markets the potential for environmental disaster is very real. For example, it is not inconceivable to calculate unregulated foreign consumption of cheap gasoline to result in environmental damage 100 fold or 1,000 fold greater than the consumption of the same *or greater* amount of such gasoline in

²⁷ See: Eicher, Mutti & Turnovsky (2009), *supra* Note 11.

²⁸ Compare: N. Gregory Mankiw, *Raise the Gas Tax*, Wall Street Journal (Oct. 20, 2006).

the United States. Any open-container spillage or evaporation of gasoline on a wider scale is almost unthinkable from an environmental perspective.

VI. On the Regressivity of Federal Excise Taxes on Gasoline.

The regressivity of the taxation on gasoline is not a myth.²⁹ The only category of taxation near to the Federal excise tax on gasoline in terms of regressivity is the combined payroll taxes paid by U.S. workers. A direct comparison between the regressive effects of the gasoline tax versus the payroll tax can be made with Table 1 here with the tax table of Bogenschneider (2014) on taxes by U.S. persons generally. A comparison of “regressivity” however can only be made specifically by pairing the data, i.e., to say the tax is regressive *as to whom* and to say whether the regressivity is increasing or decreasing over time. Here, the aggregate amount of gasoline expenditures generally has increased roughly 50% between 1985 and 2012 for the lowest income quintile of U.S. persons as a percentage of income. However, Poterba (1991) implies that the gasoline tax may not be regressive, with the following:

Low-expenditure households devote a smaller share of their budget to gasoline than do their

²⁹ Shi-Ling Hsu at 375 (2010) (“[O]ne of the persistent concerns with the gasoline tax has to do with its purportedly regressive nature. This is a myth, one that is reinforced by the “Do no harm effect” an aversion to causing harm, to the point that people would prefer a greater harm to occur by omission.”).

counterparts in the middle of the expenditure distribution. Although households in the top 5% of the total spending distribution spend significantly less on gasoline (as a share of expenditures) than those who are less well off, gasoline’s expenditure share is much more stable across the population than the ratio of gasoline outlays to current income.³⁰

However, as a matter of tax policy “middle-class regressivity” remains “regressivity”. There is nothing in the jurisprudence of tax policy to support Poterba’s (1991) assertion that tax policies favoring the ultra-rich are *not* “regressive” merely because the regressivity effects only accrue against the middle-class and not the very poor. Of course, as set forth *supra*, these statements are also grossly misleading when we take into account relative income levels of U.S. persons and the spending on gasoline by retired persons out of savings.

VII. Conclusion.

“The U.S. will remain the world’s biggest oil producer this year after overtaking Saudi Arabia and Russia as extraction of energy from shale rock spurs the nation’s economic recovery... U.S. production of crude oil, along with liquids separated from natural gas, surpassed all other countries this year with daily output exceeding 11 million barrels in the first quarter... U.S. oil output will surge to 13.1 million barrels a day in 2019 and

³⁰ Poterba (1991) at 152.

plateau thereafter, according to the IEA, a Paris-based adviser to 29 nations. The country will lose its top-producer ranking at the start of the 2030s, the agency said in its World Energy Outlook in November."³¹

The tax policy debate focuses on how to offset the regressive effects of incremental Federal excise taxes on gasoline on low-income persons. Notably, the Congressional Budget Office issued a policy report analyzing potential means to offset higher gasoline taxes on low-income households.³² Strange (2009-10) explains:

It would also be a mistake to believe that reduced payroll taxes alone will offset the regressive effect of European-style gas taxes. Even if a poor family does not own a car and, therefore, buys no gas directly, everything they purchase that has a transportation component will cost more. Unemployed poor people, or people working on a cash basis, would receive no benefit from reduced payroll taxes, and underemployed poor people may not make

sufficient income for reduced taxes to offset their increased costs.³³

As such, there does not appear to be an "easy" Pigovian answer to simply shift the externality cost to the low-income consumers of gasoline. Nonetheless, the United States Maritime Administration has the ability to grant waivers to the Jones Act restrictions on shipping in U.S. coastal waters. As a matter of international trade, the United States would benefit by allowing incremental shipment of refined gasoline from the Gulf Coast to the East Coast distribution terminals through otherwise-restricted "coastal waters". The granting of such waiver to shipping operators would create an immediate economic gain both in the Gulf Coast and the East Coast – and, could increase Federal excise tax revenue under existing law. A global environmental windfall might also occur if we assume gasoline distribution in the East Coast of the United States is better regulated than in the export markets of West Africa and Latin America.

³¹ Bloomberg News, *U.S. Seen as Biggest Oil Producer After Overtaking Saudi Arabia* (Jul 4, 2014) citing World Energy Outlook, International Energy Agency (Nov. 2013).

³² Terry Dinan, *Offsetting a Carbon Tax's Costs on Low-Income Households*, Congressional Budget Office Working Paper 2012-16 (2012).

³³ Rick Strange, *Weaving a Tangled Web: The Intersection of Energy Policy and Broader Governmental Policies*, 5 TEX. J. OIL GAS & ENERGY L. 1, 51 (2009-10).

Summaries for the 30th Annual TEI-SJSU High Technology Tax Institute

An annual conference sponsored by the Santa Clara Valley Chapter of the Tax Executives Institute, Inc. and SJSU Lucas Graduate School of Business College of Business

November 10 & 11, 2014

Palo Alto, CA

Introduction

The High Technology Tax Institute provides a high quality tax education conference that brings together nationally and internationally recognized practitioners and government representatives to provide insights on current high technology tax matters of interest to corporate tax departments, accounting and law firms, the IRS, academics and graduate tax students.

Certain sessions from the 2014 event are summarized in the articles to follow. We encourage you to read these summaries and to visit the High Tech Tax Institute website to view current and past conference materials in greater detail. If you were not able to attend the 2014 Institute, we hope this overview of the topics covered will encourage you to attend a future conference.

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FATCA (Foreign Account Tax Compliance Act) and Its Relevance to High Tech Companies

By: Amy Yue, CPA, *Open University Student*

The technology evolution has facilitated the mobility and globalization of business, but it increases the complexity of tax compliance for many taxpayers. The Foreign Account Tax Compliance Act (FATCA) is intended to identify and deter the evasion of US tax by US persons who hold assets outside the US. The latest development and the effects of FATCA on high tech companies were discussed at the 30th TEI-SJSU High Tech Tax Institute, which was held on November 10, 2014, in Palo Alto, California in a panel comprised of Pamela Endreny, Partner with Skadden; Peter Larsen, Senior Manager with Deloitte Tax LLP; and Dharmish Pandya, Partner with DLA Piper.

The panel started on who FATCA affects and the impact on those taxpayers. FATCA creates new information reporting and withholding requirements for payments made to certain foreign financial institutions and other foreign entities. Generally, withholding agents must withhold 30% of withholdable payments to non-participating Foreign Financial Institutions (FFI) and non-certifying passive Non-Financial Foreign Entities (NFFE). A withholdable payment is a payment of either: U.S. source income that is fixed, determinable, annual or periodical; or gross proceeds from the sale or other disposition (including redemption) of property that can produce US-sourced interest or dividend income.

To avoid withholding on US-sourced income, the FFIs are required to report account information of US taxpayers to the IRS, and the NFFEs must either report “substantial US owners” or certify that there is no substantial US owners. As the US adopts a worldwide tax system, US persons need to report and pay tax on income from both US and foreign sources. FATCA forms greater transparency for the IRS can match information from FFI and NFFE to US persons’ tax returns.

To simplify FATCA compliance, foreign countries may sign intergovernmental agreements (IGA) with the US government. The IGAs allow FFIs to either directly report to domestic tax authorities and the IRS separately, or report to the domestic tax authority, which will then exchange information with the IRS. FFIs in IGA jurisdictions are deemed FATCA compliant. Over 100 countries have entered or are negotiating IGAs. Countries that have signed IGAs include: France, Germany, Ireland, Italy, Netherlands, United Kingdom, Canada, Mexico, China, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and Thailand.

When talking about unique issues for high tech companies, the panel provided key classifications of FATCA affected entities such as withholding agent, FFI and NFFE. Depending on the classification, foreign entities are to complete form W-8s or “self-certifications” upon request from financial counterparties. US withholding agents are required to take the following actions to comply with FATCA: (1) identify accounts subject to FATCA, (2) obtain required documentation from account holders and verify the FATCA

status claimed, (3) determine if 30% withholding under FATCA applies and remit amounts accordingly, and (4) provide information reporting to the IRS. The withholding requirement went into effect on July 1, 2014 and the reporting requirement started on March 31, 2015.

While understanding documentation, reporting and withholding requirements of FATCA, affected entities should develop plans to get ready to comply with FATCA as its implementation stage rolls out.

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Finalized Standards for Revenue Recognition

By: Chenglei Liu, *MST Student*

Four Silicon Valley experts spoke about the latest standards for revenue recognition and the related tax considerations: Amy Chan, Director, KPMG; Irine Dibowitz, Executive Director, Ernst & Young; Patrice Mano, Partner, Deloitte; and Jesus Ochoa, Tax Director, PwC.

On May 28, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued converged standards on revenue recognition, which include ASC 606 and IFRS 15. These final standards are a product of a multi-year joint project between the FASB and IASB. The new standards virtually supersede all US GAAP and IFRS guidance on revenue recognition and require more estimates and judgments than current guidance. Following the rules, the effective date for public companies is the first quarter of 2017, but for nonpublic companies it is 2018. Public companies cannot make early adoption, but nonpublic companies may adopt as early as the effective date for public companies.

These standards are consistent between the FASB and IASB except for the following five areas:

1. The FASB version establishes a higher collectability threshold when assessing whether a contract exists (based on existing definitions of “probable” under US GAAP and IFRS).

2. FASB requires more interim disclosures than IASB.

3. IASB allows early adoption.

4. IASB allows an entity to reverse impairment losses on assets recognized.

5. FASB provides a relief for nonpublic entities relating to specific disclosure requirements, effective date, and transaction.

The core principle for those standards is to recognize revenue in a way that can correctly reflect the transaction of promised goods or services. The recognized revenue should be the amount that the transferred entity expects to be entitled in exchange of those goods or services. In order to achieve the core principle, companies may apply the following five steps:

Step 1: Identify the contract(s) with the customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate transaction price to the performance obligations

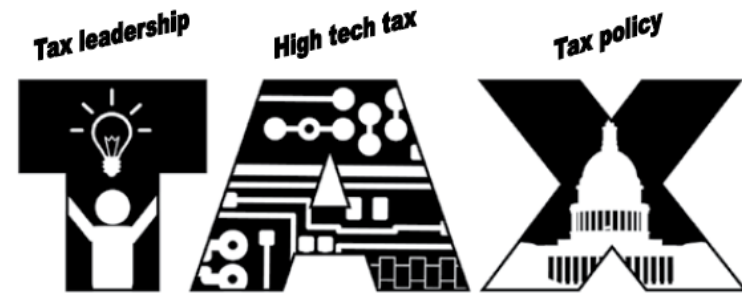
Step 5: Recognize revenue when each performance obligation is satisfied

Companies should also consider these changes in revenue recognition from a tax perspective. Certain tax liabilities are based on statutory financial statements. For example, companies who apply the deferral method for advance payment should determine their deferred taxes by reference to the amounts deferred for financial statement purpose. Also, these revenue recognition standards affect intercompany transactions. Companies should evaluate the intercompany prices and transfer pricing policies since those new standards will change revenue, profits, and third party comparables that are used to determine transfer pricing. In addition, taxpayers may need to review the methodology for the apportionment data of compiling sales.

For income tax considerations, these new standards will give rise to new temporary differences or require a different computation of existing temporary differences. Therefore, companies may need to revise their process and data collection tools. Accordingly, the valuation allowance may change due to the change of deferred tax assets, temporary difference reversals or expected future taxable income.

Multinational companies need to consider the effects of changes in revenue recognition on foreign subsidiaries. They should assess the changes jurisdiction by jurisdiction for both financial reporting and tax purposes. Companies should also consider the cumulative current and deferred tax consequences for the period of adopting the new standard.

Furthermore, there are some indirect tax effects from those new standards. Companies should review the regulations of states which has indirect state tax on gross receipts or revenue and consider the change of state net worth tax if the retained earnings changes upon adoption of the new standards.



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A Panel Discussion of M&A Developments and Acquisition Planning

By: Ryan Zhou, *MST Student*

Four M&A experts spoke about the latest developments in domestic M&A and cross-broader transactions: Gabe Gartner, Principal, PwC; Ivan Humphreys, Partner, Wilson Sonsini; David Hering, National Tax M&A Partner, KPMG; and Mark Jewett, M&A Tax Director, Amazon.com.

Mark Jewett started the discussion with an overview of the M&A process from an “in-house” practitioner’s perspective. He summarized that his responsibility in an M&A transaction is to manage the process, which requires understanding the nature of the deal.

A typical M&A process includes following five stages and Mr. Jewett highlighted the importance of each stage.

- **Pre-Term Sheet** – The importance of a pre-term sheet is to figure out the letter of intent by identifying deal structure options, analyzing tax attributes and identifying tax representations and indemnities.
- **Due Diligence** – Mr. Jewett highlighted four important points of the Due Diligence stage:
 - a. Understanding the operational process and disclosures.

- b. Analyzing tax attributes that can drive more value into the deal.
- c. Integration. To consider a company and an acquired structure that are necessary to integrate into the overall business process – including moving people and assets accordingly.
- d. Purchase Accounting. Mr. Jewett emphasized that he always needs accountants to identify tax attributes and historical tax differences, significant deficiencies and material weaknesses at the due diligence stage.

- **DPA (Definitive Purchase Agreement) Negotiations** - A DPA is a legal document that records the terms and conditions for a purchase or sale of a business. It is a mutually binding contract between the buyer and seller. Mr. Jewett pointed out that it is key for tax practitioners to understand the architectural structure of these agreements from a tax perspective to make sure the direction of a merger is correct. He continued to emphasize the importance of including the tax indemnity section in agreements because M&A trends in recent years are leading towards acquiring profitable companies.
- **Closing** – Panelists explicitly pointed out one important part of the closing process often is forgotten, is to withhold the proper amount of payroll.

- **Post-Close Integration** - Mr. Jewett shared that they often spend an enormous amount of time on moving IP rights among various tax regimes at this stage of the M&A process. They also need to create an effective tax structure to avoid having inter-company transactions.

The panel discussion moved on to discussing the external IP buy-in structure.

Mr. Jewett shared with the audience that “I always structure a deal as an asset purchase if I can.” He further explained his idea in two steps:

Step 1: The Foreign IP company directly acquires assets or licenses for ROW (“right of way”) IP rights from a target company.

Step 2: The US IP company acquires all US legal titles and IP rights that are subject to the foreign IP company licenses.

In addition to the benefits of amortizing the step-up basis, Mr. Jewett explained that the asset purchase structure can push the buy-in cost into the transaction, and there will be no post transaction tax consequences.

Ivan Humphreys presented on how to extract value in domestic acquisitions. He illustrated the concept with four typical scenarios that include venture-backed loss corporations with or

without stock option pool, venture-backed loss corporations acquired at a breakeven point, and where the target is a pass through entity.

The next panelist Gabe Grartner from PwC updated the audience on M&A technical developments. He briefly illustrated IRS Notice 2014-32, which stated that Triangular Reorganization subject to Treas. Reg. § 1.367(b)-10 would continue to result in a deemed distribution, but a deemed contribution is eliminated.

The last topic of the discussion led by David Hering from KPMG was on Inversion Transactions.

Mr. Hering introduced the basic understanding of three different charges that U.S. taxing authorities have developed to prevent corporate inversions. He emphasized the concept that “inversion really does nothing with your effective tax rate” and highlighted the IRS Notice 2014-52’s measure on how the government would make inversions more costly.

All the panelists with ample experience brought in the most current updates and insights of M&A Developments and Acquisition Planning. The audience was well informed on these topics.

Tax Maven

The Contemporary Tax Journal's Interview of Handy Hevener

By: Jun Xie, *MST Student*



Ms. Mary B. "Handy" Hevener is a partner in Morgan Lewis's Employee Benefits and Executive Compensation Practice. Ms. Hevener focuses her practice on Social Security benefits, executive compensation, and a wide range of fringe benefits. Prior to joining Morgan Lewis, she served as an attorney-adviser for the U.S. Treasury Department's Office of the Tax Legislative Counsel. Ms. Hevener has been a well-known expert in the field of benefits taxation since the 1980s.

I had the pleasure of interviewing Ms. Hevener on November 11, 2014 after we attended the 30th Annual TEI-SJSU High Technology Tax Institute Conference where Ms. Hevener was a presenter. During our conversation, Ms. Hevener shared her experiences in the tax field and offered advice for MST students. Below are the questions asked and a summary of Ms. Hevener's responses.

SJSU CTJ: How did you get involved in the tax field?

Ms. Hevener's mother was a real estate lawyer and worked for a tax firm. So when Ms. Hevener was little, she helped her mother, and found the work quite interesting. At the age of five, Ms. Hevener got her first paid job of filing pages in Tax Management Portfolios for a nickel an hour. From that experience, she found it was more fun to become a tax attorney than a real estate attorney. Therefore, she went to the University of Virginia, which had a fine tax program in its law school. After graduation, she spent three years working at the D.C. law firm that was associated with Tax Management, so she wrote many articles for various Tax Management

publications, while also being an associate working on general tax matters. Then she went to the Treasury Department and worked in the Office of Tax Policy from 1981 to 1984. After that, she joined another D.C. tax boutique law firm. Ms. Hevener says that since the time she could read, she never deviated in wanting to become a tax lawyer.

SJSU CTJ: What led you to specialize in the employee benefits and executive compensation area of tax practice?

Ms. Hevener has always been interested in Social Security, which she thought was an exciting area of law to study. In addition, she is fascinated as to how the tax system operates and why we have a system in the U.S. that works a lot better with respect to having people pay taxes and pay on time. Considering that there are about two hundred million taxpayers but a limited number of IRS auditors, the operation of the tax system has to rely largely on a system of information reporting and withholding. Ms. Hevener found this interesting. Two of her favorite professors from law school were Mortimer Caplin and Edwin Cohen. Mr. Caplin had served as Commissioner of the IRS under President Kennedy, and Mr. Cohen was Under-Secretary for Tax Policy at the Treasury Department. The two professors taught Ms. Hevener not only law cases, but also how the tax law was created and why the system worked. Therefore, Ms. Hevener started thinking about tax system and information reporting and withholding when she was in law school.

Another thing that coincidentally happened was that when Ms. Hevener graduated from law school in 1978, there were a lot of changes to benefit laws, and information reporting and

withholding rules. The Congress had put in place some new laws in this area. Since Ms. Hevener was the youngest attorney at her firm, she was asked to write summaries and articles about these new changes. So, she read about these subjects and really got to know this area at the ground level. When she got to work in the Treasury Department, she went in with some expertise in the benefits area. She worked on administrative aspects of the Social Security Act of 1983, and become even more familiar with this area. Ms. Hevener's strength in the area of Social Security played into her second expertise in executive compensation. In 1993, the Medicare tax became applicable to all wages, so people got more serious about employment taxes. Since Ms. Hevener was known for her expertise in this area, she became the go-to person in her firm. She managed to combine her expertise of Social Security with executive compensation, in designing nonqualified deferred compensation plans for many companies.

SJSU CTJ: What stands out as one or two most significant accomplishments in your career?

Ms. Hevener explained that one of the most frustrating things about tax litigation is winning at the lower court, and then having the result reversed at appeal, particularly when the reversal arises due to a completely separate case, for a different taxpayer. She shared an experience of a case involving tens of millions of dollars in FICA taxes on severance pay. She and her colleagues won the case in the Sixth Circuit Court, but later others argued the case in the Supreme Court and the taxpayer lost. From this experience, she discovered settlement with the IRS or with Justice Department litigators is often the quickest

and most satisfactory way to resolve tax controversies. Then the result cannot be reversed at appeal. These victories happened in a number of cases for Ms. Hevener. She won a case on payroll exemptions for incentive stock options and another on the tax treatment of food in company cafeterias. She finds it to be a great accomplishment to help the clients solve their issues and in the most efficient way.

SJSU CTJ: What do you think is one area related to employee benefits taxation that could or should be improved and why?

Ms. Hevener said it would be great if the Congress would expand the law to allow firms handling payroll tax cases to get their attorneys' fees reimbursed if the taxpayer wins. That change would make a big difference on the IRS's enthusiasm in raising cases that are not compelling. It can take lot of steam out of the desire to litigate when the IRS knows that it would have to pay for the taxpayer's litigation costs if the IRS loses.

SJSU CTJ: What do you think is the biggest challenge facing tax professionals today?

Ms. Hevener thought that the biggest challenge facing tax professionals today is the tremendous amount of time that takes to get a case go through the court. The IRS is so under-staffed and under-budgeted that it may take years to litigate a case. The whole process becomes very frustrating for tax professionals and even more so for their clients. And there are potential liabilities as well as risk of interest and penalties.

SJSU CTJ: What advice do you have for students who are preparing for a career in the tax field?

Ms. Hevener reminded students that a merely "keyword" search is not the only way to resolve an issue. You may get a fast answer, but likely the answer is either wrong or not complete. The Internal Revenue Code has a special structure that is not designed for keyword search. To excel at work, Ms. Hevener encourages students to focus deeply on the research courses, and gain a strong understanding of how the Code is structured and how the legislative process works. She also suggested students spend one or two years working for the U.S. Tax Court, IRS or state tax authority. Students can learn a lot by knowing how the other side works.

Fun Questions:

SJSU CTJ: If you could have dinner with anyone, who would it be?

Ms. Hevener would love to dine with the current editor of the *New Yorker*. She likes the magazine and the *New Yorker* has always been her favorite thing to read.

SJSU CTJ: What is the most unusual item in your office or something that has special meaning?

One item that has special meaning in Ms. Hevener's office is a baseball signed by Bobby Thomson, who hit a home run and helped the New York Giants win in 1951.

One year, to celebrate the birthday of Ms. Hevener's husband, she donated to a charity and asked Mr. Thomson to call her husband who is a great fan of baseball. The next year, Ms. Hevener called Mr. Thomson again indicating she would like to get a signed baseball as a birthday present. She agreed to donate to any charity Mr. Thomson named. However, over the phone, Mr. Thomson suggested that Ms. Hevener gave him the money and then he would donate the funds to a charity. Ms. Hevener said, "Oh, I can give you the money but then you will have to report income. I am helping you to save some self-employment tax by donating it directly". She wanted to make sure Mr. Thomson was aware of the tax consequences and was okay with it because there were several tax controversies of underreporting income for famous baseball players at that time. He was surprised and asked how Ms. Hevener would know. She said, "I am a tax lawyer." As an end to the story, in that year, Ms. Hevener got two signed baseballs: one for her husband as a birthday present, and the other one for herself. Written on her baseball: "To Mary Hevener, thanks for the tax advice, Bobby Thomson". It remains one of her prized possessions.

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Focus on Tax Policy

Attempted Repeal of Personal Casualty Loss Deduction

By: Nidhi Jain, *MST Student*

On February 26, 2014, Dave Camp, former Congressman and Chairman of the Ways and Means Committee of the U.S. House of Representatives, released the “Tax Reform Act of 2014,” (H.R. 1, 113rd Congress) as a discussion draft. The bill was formally introduced to the House on December 10, 2014. The main feature of Camp’s plan was the broadening of the tax base coupled with lowering of the individual and corporate tax rates, and repealing or limiting business and individual tax deductions, credits, and income exclusions.

One of the proposals in the Act (Sec. 1406) would repeal the personal casualty and theft losses deductions for individuals. To better appreciate the context of this proposal, it is relevant to note that other deductions would also be repealed, such as medical expenses, non-business state and local taxes, employee business expenses, and some miscellaneous expense). Businesses would continue to be able to deduct casualty losses.

With the repeal of various itemized deductions, Chairman Camp also proposed to increase the annual standard deduction. The proposal estimated that 95% of taxpayers would choose the standard deduction as opposed to itemizing their

deductions, thereby resulting in a significant decrease from the one third of taxpayers who itemize under current law.³⁴

According to the Internal Revenue Service, a loss is a casualty loss if the damage, destruction, or loss of property results from an identifiable event that is “sudden, unexpected, and unusual.”³⁵ A theft is the “taking and removing of money or property with the intent to deprive the owner of it.”³⁶ For a theft to qualify, it must be considered illegal under state or local law and must have been done with criminal intent. Theft includes taking of money or property through blackmail, burglary, embezzlement, extortion, kidnapping for ransom, larceny, and robbery.

Federal tax law allows a taxpayer to deduct losses caused by fire, storm, shipwreck, other casualty, or theft if they itemize their deductions on their income tax return. Losses are allowed only to the extent that the taxpayer is not reimbursed for the losses through insurance or other compensation. The rationale behind these deductions is to provide some relief to taxpayers who have diminished ability to pay their federal income taxes because of large, unpredictable, and unavoidable losses. These deductions are *generally* limited for individual taxpayers for each loss in excess of \$100 and 10 percent of the taxpayer’s

³⁴ Council on Foundations, “Tax reform Act of 2014: Summary of Provisions Affecting Exempt Organizations,” July 1, 2014, p.2. <http://www.cof.org/sites/default/files/documents/files/Tax-Reform-Act-of-2014%20Summary.pdf>

³⁵ Rev Rul 72-592, 1972-2 CB 101

³⁶ Rev Rul 72-112, 1972-1 CB 60

adjusted gross income.³⁷ For example, suppose an individual taxpayer's car worth \$25,000 is totally submerged in the flood resulting in a complete loss of the vehicle. The taxpayer filed an insurance claim and received \$5,000. Therefore his personal casualty loss is \$20,000. Applying the limitations to the taxpayer's AGI (adjusted gross income) of \$40,000, the taxpayer can claim a deduction of \$15,900. If the deductible casualty loss is large enough an individual taxpayer may generate an NOL (net operating loss) and has the option of carrying that NOL back generally three years or forward for up to 20 years.

The present system of personal casualty and theft losses deductions has several drawbacks. First, these deductions are difficult to administer because they provide an uneven kind of disaster assistance and such assistance is only available to those individuals who itemize their deductions. Second, the amount of the effective assistance (via the deduction) for a given loss increases with the taxpayer's marginal tax rate. Third, valuing the loss may be difficult. For instance, the loss of basic necessities of life does not receive the same tax treatment as the loss of a luxury item, and the tax law does not compensate for both equally. Fourth, a deduction is allowed only for sudden and unexpected losses. For example, a deduction is not allowed if the damage or destruction of trees, shrubs, or other plants is caused by a fungus, disease, insects, worms, or similar pests. However, a sudden destruction due to an unexpected or unusual infestation of beetles or other insects may result in a casualty loss. Finally, the current system may

encourage some taxpayers to buy less insurance to protect themselves against disasters because the deductions are allowed only to the extent that the taxpayer is not reimbursed through insurance.

The tax policy analysis below on "Proposed Repeal of Personal Casualty Loss Deduction" uses the ten principles of good tax policy as published by the AICPA³⁸. This analysis will help us know the strengths and weaknesses of this proposal for various taxpayers who suffer casualty or theft losses and if this proposal will be beneficial for the economic growth and efficiency of the United States.

³⁷ IRC §165(h)

³⁸

http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Tax_Policy_Concept_Statement_No.1.doc

Principles of Good Tax Policy Worksheet

Criteria	Application	+/-
Equity and Fairness Similarly situated taxpayers should be taxed similarly.	<p>Elimination of this provision could increase taxes for those unfortunate taxpayers who live in a state prone to natural disasters such as fire, storms, or floods. Therefore, instead of being able to deduct casualty losses to the extent they exceed slightly more than 10% of AGI, the deduction for all would be zero. This would also invalidate deductions for victims of conventional thefts.</p> <p>Vertical Equity: Under the current rule, the taxpayers would be able to claim the deductions only if they exceed the standard deduction, which is \$12,600 in 2015 for most taxpayers with a married filing joint return.³⁹ The proposal attempted to increase the basic standard deduction to \$22,000 for a married couple filing jointly with the repeal of the personal casualty and theft losses deduction while keeping the charitable and mortgage interest deduction intact.⁴⁰ This would result in a decrease in the total number of itemized deductions and a decrease in the tax benefit to some taxpayers who would currently itemize charitable and home mortgage interest deductions.</p> <p>Eliminating the personal casualty and theft loss deductions would negatively impact some taxpayers with relatively high losses, as no deduction would be allowed under the proposal. The current deductions</p>	<p>-</p> <p>- For vertical equity</p>

³⁹ Rev Proc. 2014-61, 2014-47 IRB 860

⁴⁰ Congress.Gov, "H.R.1 - Tax Reform Act of 2014, 113th Congress (2013-2014)," Dec 10, 2014
<https://www.congress.gov/bill/113th-congress/house-bill/1>

	<p>favors high-income taxpayers who obtain greater tax savings per deduction dollar than lower bracket taxpayers, although they have higher AGI floors above which they can take the deduction.</p> <p>Horizontal Equity: The proposal would achieve the horizontal equity concept. The current rule provides the deductions based on the limitations set at \$100 per casualty plus 10% of AGI. With the change in the provision, taxpayers with equal abilities to pay would not be affected since the amount of casualty and theft loss is determined by the 10% AGI limitation.</p> <p>It is logical therefore to repeal this deduction because for most taxpayers the deduction has already been effectively unavailable by reason of the floor under the deduction equal to the 10% of adjusted gross income. However, equity and fairness still would not be achieved.</p>	+ For horizontal equity
<p>Certainty</p> <p>The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.</p>	<p>Eliminating the personal casualty and theft loss deduction would increase certainty because the definition of casualty and theft, timely claim of insurance, and other elements are too broad and complex. For instance, a deduction is allowed for ornamental shrubs struck by lightning but is not allowed for the same shrubs lost gradually to winterkill.</p> <p>While the law does explain how the amount is to be determined, the calculation itself can be confusing. Even though tax software makes the loss deductions easier to calculate, many taxpayers may not have enough assurance on the correctness of the calculation. Taxpayers may need to take great efforts to figure out which special rule would apply to their particular situation and how to calculate their losses. The regulations pose many complex problems of definition, valuation, and</p>	+

	computation, requiring some of the most difficult factual determinations in taxation. Distinguishing between "sudden losses" versus "progressive deterioration" becomes difficult at times. The IRS has provided a Form 4684 to specifically compute the loss. Because of the complex nature of this deduction, many taxpayers simply lack the tax expertise to compute the loss themselves, thereby forcing them to consult a tax preparer. This results in an added compliance and paperwork costs. Thus, eliminating this deduction would result in considerable tax simplification.	
Convenience of payment A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.	Timing is usually a problem in theft situations where the loss is usually claimed in the year of discovery or later if there is a reasonable prospect of recovery. The deductions would likely be deferred in cases when a taxpayer brings about litigation to recover his stolen items. Eliminating the casualty and theft loss deduction altogether would have a positive affect on timing of payment to individual taxpayers.	+
Economy in collection The costs of collecting a tax should be kept to a minimum for both the government and taxpayers.	<p>Eliminating the personal casualty and theft loss deduction provision would improve economy in collection. The IRS would collect fewer forms and need fewer audits to ensure that taxpayers who claim this deduction are in full compliance with the law. Therefore, the cost of administration for the IRS would be greatly decreased.</p> <p>The current rule warrants the taxpayers to keep extensive recordkeeping and devote time and efforts in producing them to determine how much of the deduction would be allowable to them. Elimination of this provision would reduce the recordkeeping burden on taxpayers that would in turn help in diminishing their compliance costs.</p>	+

<p>Simplicity</p> <p>The tax law should be simple, so taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.</p>	<p>It could be difficult to claim a casualty loss for damage or theft to personal property because the tax law imposes limitation, special rules, which are difficult to understand. Taxpayers who anticipate claiming such itemized deductions are required to keep extensive recordkeeping. And even when they claim such deductions, the taxpayers frequently make errors regarding what types of casualty or theft losses are properly allowable. Sometimes issues arising out of litigation could last a few years such as when individuals sue insurance company or other party to try to get compensation for the loss.</p> <p>Eliminating the personal casualty and loss deduction would significantly simplify the tax code because the scope of the definition of “casualty” and “theft” is broad. The IRS and many individual taxpayers spend considerable time and money on compliance and administration each year. Eliminating this provision would be cost-efficient for both the IRS and the taxpayers.</p>	<p>+</p>
<p>Neutrality</p> <p>The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>Currently, the personal casualty and theft loss applies to all individuals, trade and business, as well as those in federally declared disaster areas. The proposal attempts to repeal this provision for individual taxpayers while businesses would still be able to deduct the casualty and theft losses.</p> <p>Repealing the provisions for individual taxpayers would greatly affect those taxpayers who live in areas where the chance of being impacted by a casualty is very high. These taxpayers could be motivated to move somewhere else and it would greatly affect the investment in property in that area. Taxpayers who become the victim of theft or fraudulent scheme would also suffer greatly.</p> <p>If the deductions were eliminated, the taxpayers would be more reliant</p>	<p>-</p>

	on insurance to cover them from such losses. A large casualty loss might make their itemized deductions exceed more than their standard deduction for the year. But because only 1/3 rd of individual taxpayers itemize, Camp's proposal to increase the standard deduction would come to their rescue.	
Economic growth and efficiency The tax system should not impede or reduce the productive capacity of the economy.	The Camp's proposal to eliminate the personal casualty and theft loss deduction suggests that it would broaden the tax base, and therefore raise tax revenues. Increased revenue could allow a reduction in the corporate (and other) tax rates that, in return, may improve the competitiveness in the US market. Based on the analysis by the Joint Committee on Taxation, the Camp proposal would increase GDP growth by \$3.4 trillion, thereby resulting in an additional 1.8 million private sector jobs over the next ten years with increased wages. ⁴¹ However, base broadening could have unintended side effects such as effects on savings incentives for low-income taxpayers and creating tax liabilities which they cannot afford to pay.	+
Transparency and Visibility Taxpayers should know that a tax exists and how and when it is	The current provision of casualty and theft loss is quite perplexing. It discriminates against those who insure (since insurance premiums are generally not deductible for individuals on personal-use property) and reimburses taxpayers via a deduction according to a 10% AGI threshold.	+

⁴¹ Tax Reform For Growth, "Dave Camp's plan would yield \$700 billion in extra 'dynamic' revenue", *The Wall Street Journal*, Feb 26, 2014 <http://www.wsj.com/articles/SB10001424052702304255604579407112591695536>

imposed on them and others.	Eliminating the personal casualty and theft loss should improve transparency and visibility. Taxpayers would then know that no such deduction exists for any casualty. Tax reporting and calculations would become more transparent and visible for all taxpayers.	
Minimum tax gap A tax should be structured to minimize non-compliance.	Eliminating the personal casualty and theft loss deduction would reduce the tax gap because the complexity of the provision may lead to accidental or unintentional errors. However, with this proposal taxpayers may illegally evade taxes by claiming business casualty loss on their personal use asset because the deductions for business casualty losses would still be allowed.	+/-
Appropriate government revenues The tax should enable the government to determine how much tax revenue likely will be collected and when.	The government can easily determine how much tax revenue would be collected if this provision is no longer in existence based on historical deductions but future tax increases via the elimination of the deduction would be difficult to predict based on the ever-changing levels of personal casualty deductions every year. According to JCT revenue estimates, this provision taken together with other provisions ⁴² in the proposal would increase revenues by \$858.4 billion over 2014-2023. ⁴³	+

⁴² The revenue estimates for repeal on personal casualty and theft losses are reported as a combined, aggregate revenue effect of a number of separate provisions.
⁴³ Joint Committee on Taxation, “Estimated revenue effects of Tax Reform Act of 2014 fiscal year 2014-2023(billions of dollars),” *House Ways and Means*, Feb 26, 2014 http://waysandmeans.house.gov/UploadedFiles/JCT_Revenue_Estimate_JCX_20_14_022614.pdf

Applying the rules for personal casualty and theft loss deduction to a fact pattern is not easy and straightforward – typically because of the amount of loss subjectivity. Computational loss rules and the netting requirements of the rules generally result in different tax treatment to taxpayers, who have suffered like economic losses to uninsured or partially insured personal property.

To reduce the inequities and make it easy to administer from the standpoint of tax theory, getting rid of personal casualty and theft loss deduction altogether as suggested by Camp's proposal would be a good option. An alternative to outright repeal of the personal casualty and theft loss deduction would

be repeal plus allowance of a deduction for all or a percentage of the cost of premiums for casualty and theft loss insurance covering real property and personal property by individuals on personal-use property. This alternative has the advantage that it not only removes the government from the role of an indirect co-insurer but it also provides a positive incentive to purchase casualty and theft loss insurance. Another alternative would be allowing some deferred tax payment option for taxpayers below a certain income level. This would help the taxpayers who would otherwise face problems paying taxes due to a casualty or theft loss as evidenced by living in a presidential area or having a police report filed for theft loss or an insurance claimed for a casualty loss.



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